TRIVETT WEALTH MANAGEMENT

IMPACT OF TAX REFORM

ON RESIDENTS, FELLOWS, AND ATTENDING PHYSICIANS

By: Matthew J Trivett CFP® ChFC® CLU®

The intent of this white paper is to provide insight as to the implications of the newly passed TAX CUTS AND JOBS ACT on doctors. The TCJA is the largest tax reform bill in nearly 3 decades. While the scope of this paper is aimed at the medical physician, other professionals will likely find pertinent data as well. I have cherry picked the data as I see relevant to my average client (the younger physician -residents, fellows & attendings – living in the Appalachia region). I have categorized the points so that the reader can skip sections that are not relevant to their individual situation.

RESIDENTS/FELLOWS

1) Student Loans
   - There were no changes made to the deductibility of student loan interest. It will remain limited to $2500 annually.
     - The income limit for deducting your SL interest is still $80k (single), $165k (married). So, as it were, you are generally able to "write off" your SL interest while in training, but probably earn too much after graduation.
       - Keep in mind that the above income limits are only for single and MFJ. If you file *married filing separate* (which many of you do in order to qualify for lower payments under PAYE or REPAYE) you are disqualified from deducting SL interest.

2) Contract Negotiations and Those Still Deciding on A Career Path

The TCJA created a 20% qualified business income deduction for pass through entities – a point that will come up considerably throughout this writing. Ultimately this has made the independent contractor model (as well as partnerships, sole proprietorships, and other pass-throughs) more attractive from a tax standpoint. Therefore, if prospective employers are willing and able, you should consider structuring yourself as a 1099 contractor, if not completely going the **locum tenens** route.

Be aware that under this arrangement the employer will likely not offer benefits. So, although raw compensation may be the same, the overall package will not; and as a result, during your negotiation you will want to push for higher compensation (aka: "true up") to rectify the otherwise lost benefits.

Some employers will likely not accommodate your request to be a 1099 as it can violate the 3 IRS common law factors (*behavioral control, financial control, and type of relationship*). This is more common with larger employers. Some experts say physicians may be exempt due to their "learned professional" status but unfortunately there is no clear line.

On a side note, absent the new tax law, I have always looked favorably upon the independent contract arrangement (aka: locum tenens) due to the income potential and ability to adopt a solo 401k and other customized benefits – I won't comment on the less tangible lifestyle piece as that is 100% personal preference, other than to say, some love it and some hate it. However, I can state confidently that my clients who elect the locum route, on average, earn more income.

> **As a physician you are considered a *Personal Service Business*, which subjects you to a pro-rata phase out beginning at $315,000, and totally disappears at $415,000 ($207,500 single) of 'taxable income'.**
>
> *I'd like to draw your attention to the term 'taxable income.' This will always be less than Gross Income or Adjusted Gross Income. One's taxable income is after all deductions. Let's take an admittedly oversimplified example of a married independent contractor (aka full-time locum) working as a hospitalist or ER doctor. Notice that although they may earn above $315,000 that doesn't automatically disqualify them from taking the 20% deduction on qualified business income, since "taxable income" is what matters.*

	GROSS INCOME	$370,000
-	Solo-401k	$55,000
-	HSA contribution	$6,900
-	Standard ded	$24,000
=	Taxable Income	$284,100

IMPORTANT*: *The eligibility for the 20% pass through deduction is complex and I strongly urge the reader to consult his/her CPA or tax attorney regarding this part of the TCJA.

3) Geography Now Matters More When Choosing Your Employer

One of the ways Congress dealt with lower income tax revenue resulting from TCJA was to cap certain deductions. The biggest (and arguably, the most controversial) was limiting state and local tax deduction to $10,000. ***Where you choose to work after graduation now merits greater consideration***. Generally, denser populated states and cities will carry more state & local taxes. Places like Chicago, San Francisco, and New York won't provide near the tax benefits than smaller (generally less populated) municipalities can offer. Another reason I love our region!

ATTENDING PHYSICIANS

1) Currently Self-Employed

Given that tax tables will be more favorable in 2018 vs. 2017, you should **consider doing everything possible to reduce your 2017 income BEFORE you tax filing deadline**. Unfortunately, at this point your options are limited to vehicles that permit 'tax year' contributions. The best example is the SEP IRA and solo 401k. These 2 accounts will allow you to contribute now (the solo 401k must have been established by December 31, 2017), and code it as a 2017 contribution. The maximum for these plans varies but is around 20%-25% of net schedule-C income to a maximum of $54,000. The deadline for this is April 17, 2018 (Oct 15 for those with extension).

Also, if you have an HSA eligible insurance policy, make sure you've maxed out your 2017 HSA contribution ($3,400 single, $6,750 MFJ).

2) Practicing in a Private Group

Everything mentioned in the previous section (for self-employed MDs) also applies to those in partnerships. However, one difference is that most physician partnerships maintain a profit-sharing plan (in conjunction with a 401k) in lieu of a SEP or solo-401k. It's too late for additional employee deferral ($18,000 for 2017). However, the profit-sharing deposit can be made retroactively. If you have a profit-sharing provision you should try to contribute as much as possible (assuming all partners agree since this is a corporate decision). In my experience most groups will do this sometime in March, but it can be done up until the tax filing deadline.

3) Employed W-2 Attending Considering a Job Change

As discussed in the *resident/fellow* section, there are now greater benefits to moving to a private practice, locum tenens, and/or partnership arrangement. If you have been leaning this direction, 2018 may provide a good opportunity to make the leap. Or, if you wish to still practice alongside other MDs then consider moving toward the partnership arrangement. This is because of the 20% deduction for pass-through entities (SEE "*Contract Negotiations and those still deciding on a career path*" under the RESIDENTS section).

4) AMT (Alternative Minimum Tax)

I hate this thing. I hated learning how it works during undergraduate studies, and years later I hated relearning it for various industry licensure and certification exams. Even worse I hate how it has cost clients' money year after year. It has been a perpetual thorn in the side of medical professionals since it's 1970 inception. Well there's finally good news. **The AMT exemption has increased dramatically** to $1,000,000 for joint filers and $500,000 for individuals. In other words, the full AMT exemptions can be taken by taxpayers who earn less than these thresholds, and the exemptions don't go away entirely until AMTI of $1,437,600 for couples, $781,200 for singles and heads of household, or $718,800 for married individuals filing separately. Very few of those physicians reading this will be affected by the AMT going forward.

5) Itemizing Deductions

TCJA repeals the IRC Section 68 (aka: "Pease" limitation) which phases out 3% of a taxpayer's itemized deductions once income crossed $313,800 (MFJ). Accordingly, the removal of the Pease limitation effectively further reduces marginal rates for upper income individuals. So, assuming you won't be taking the standard deduction – which is now a bigger "if" since the standard deduction has effectively doubled - you will now be able to deduct all schedule A deductions regardless of income.

6) 457b Plans

There seems to be some adverse implications in the bill on deferred compensation plans. For many of you this includes 457b plans. I would expect to see some changes here in the next year or two if you have one of these plans. The distribution options may become less attractive such that many doctors will opt to invest elsewhere instead of using a 457. I'm still wrapping my head around what these changes are going to mean, but you may wish to put any 457 plan contributions off until things become clearer.

FOR ALL PHYSICIANS (RESIDENTS & ATTENDINGS)

1) Those with children in private school

As higher income earners, many of you chose to enroll your children in private school. The TCJA includes a provision that allows 529s to be used for primary education (prior to the Bill's passage section 529 accounts were strictly for college and graduate level studies).

> *My opinion*: I don't love the idea of using 529 plans for primary education. The primary benefit of 529 savings is the tax deferral of asset growth, which is a benefit that increases with time. Why would you want to interrupt this process? Let it do its job by giving it adequate time. Plus, college tends to be a larger financial burden than prep school, and as a high-income earner you should be able to cash flow private primary school. But college is probably a different story. Therefore:

You can do it BUT ***I don't think you should****.*

Another point to mention: Some 529 savings account contributions are deductible at the state level (Virginia being the one I see most often) **IF** you utilize that state's plan. In addition, some states permit retroactive contributions (Georgia and South Carolina being the only ones considered part of the

Appalachia region). So, if you reside in one of these states you can still contribute to your state's 529 for 2017 up until your tax filing deadline and deduct it on your 2017 state tax return.

2) Home Owners

By most standards, most doctors own expensive homes. The TCJA just made home ownership slightly less appealing for those with higher incomes and larger mortgages for 2 reasons:

1. Your mortgage interest deduction may have just become a moot point.
    - In 2018 the standard deduction doubled. This is a good thing, but now many folks will no longer benefit from itemizing since they will need at least $24k (MFJ) of schedule A deductions to exceed the standard deduction. Although those who have a mortgage and give to charity are more likely to continue to itemize.
2. Reduction to the mortgage debt limit for the mortgage interest deduction was reduced to $750,000 ($375,000 for separate filers) for **newly acquired homes**.
    - Because your existing mortgage is grandfathered under the old higher $1 million limit, you may want to delay that future dream home or consider putting more down to stay under the $750k cap.

UPDATE: *On February 21, 2018 the IRS issued a release explaining that the law suspends the home interest deduction* ***only for interest on home equity loans that aren't used to buy, build or substantially improve the taxpayer's home that secures the loan****. This is good news for those with home equity debt, as it was originally thought that ALL HELOC interest was no longer deductible, regardless of its purpose.*

3) "HSA eligible" insurance policy?

Also, don't overlook your HSA. If you had an "HSA eligible" plan in 2017 you are able to contribute $3,400 for individuals ($6,750 for those with family coverage). This pre-tax contribution can be made retroactively for 2017 up until April 17, 2018. This is low-hanging fruit that should not be ignored.

4) Divorce

According to a 2015 study by *The British Medical Journal*, 24% of actively employed physicians report being divorced (in case you're curious, doctors fair better than other healthcare professionals – health care executives came in at 31%, nurses were 33%, and dentist were 31%). But no matter how one slices the data, it's still a high number.

The TCJA eliminated deductions for alimony payments required by <u>post 2018</u> divorce agreements. Therefore, if you find yourself going through separation/divorce, try to get everything finalized in 2018 if you're the payor, and try to hold off if you're the payee.

5) <u>Physicians who hire a financial professional</u>

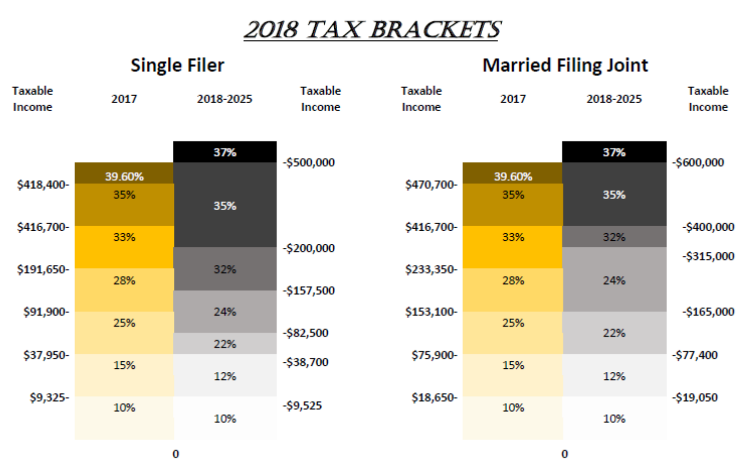
The TCJA eliminated the miscellaneous itemized deduction (which was subject to the 2% of AGI floor). This effectively wiped out the ability to deduct your "advisory fee" on non-qualified account. NOTICE: This does not affect retirement accounts, only non-qualified investment accounts. So, if you use my firm or another advisor who charges you a "planning fee" or "advisory fee," this will no longer be deductible.

6) <u>How will the bill affect the growth of my investment accounts</u>?

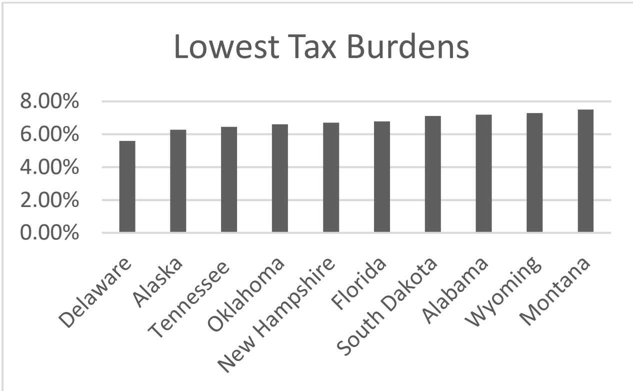
This was covered in my 2017 4th quarter newsletter. Go here to read the full article: <u>https://www.trivettwealthmanagement.com/resources.html</u>

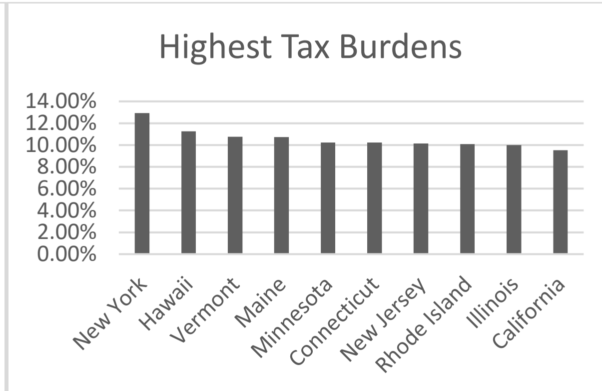
GENERAL THOUGHTS

Most medical professionals will see a reduction in their tax bill, if for no other reason, simply because of the lower brackets. Below is a comparison of the 2017 vs 2018 brackets.



For most of my clients living in the Appalachia region, this is especially true. The biggest way Congress dealt with decreased tax revenue - resulting from the TCJA - was to limit deductions for state & local taxes. However, our region is amoung the lowest in the nation which makes this limitation negligible for most. See the chart below for states with the highest and lowest average tax rates.





If I had to pick the one piece of the TCJA which carries the most impact on doctors, I would say it's the 20% deduction of qualified business income for pass-throughs (as I'm sure you've probably noticed it's reoccurrence throughout this whitepaper). This poses the greatest benefit for many physicians if they structure things properly (I will once again compel you to talk to a CPA or tax attorney due to the complexity and the substantial ramifications of getting this part wrong).

Of final mention, I would like to emphasize this point: PLEASE DON'T ALLOW THE ISSUE OF TAXES TO BE THE PRIMARY DRIVER OF YOUR FINANCIAL DECISIONS. It's easy to get excessively ambitious with complex tax strategies - plus, one should remember that the legislation is set to sunset in 2025 (whether this will happen is anyone's guess). My intent with this paper is to provide insight to the TCJA bill. At the same time, ***my advice continues to be that your plan (which ought to be intentionally engineered based on your goals, and monitored by a competent & trusted professional) is the main determinant of your money decisions. The plan is everything. All else serves at the plan's altar, and in many cases is merely ornamental****. To that end I welcome the opportunity to discuss holistic financial planning with you, and the proper role of tax management as the servant of the plan. As always, please send me any feedback, questions, and suggestions for future articles. I hope everyone's 2018 is off to a prosperous start!*

Sincerely,

Matthew J Trivett CFP® ChFC® CLU®